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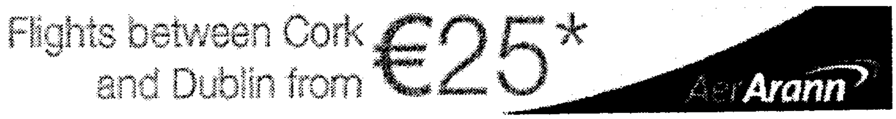


# INTERNATIONAL

## US Multinationals Overseas Profits: Ireland's patent income tax-exemption may fund over 5% of Irish Government annual spending in 2006

By Finfacts Team
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Earlier this month, The Wall Street Journal wrote that "*a law firm's office on a quiet downtown street [in Dublin, Ireland ] houses an obscure subsidiary of Microsoft Corp. that helps the computer giant shave at least $500 million from its annual tax bill. The four-year-old subsidiary, Round Island One Ltd., has a thin roster of employees but controls more than $16 billion in Microsoft assets. Virtually unknown in Ireland, on paper it has quickly become one of the country's biggest companies, with gross profits of nearly $9 billion in 2004.*"


Pfizer was one of the first US pharmaceutical businesses to locate in Ireland and set up its first production facility in Ringaskiddy in 1969 to produce food chemicals, including citric acid and gluconate products. In 1972 a further production plant, Organic Synthesis Plant 1 (OSP1), was constructed to produce bulk pharmaceutical products. A second Organic Synthesis Plant (OSP2) was completed in 1984, effectively doubling production capacity to meet the increasing demand for pharmaceuticals and a widening range of products. In 1990, Pfizer sold its worldwide citric acid business to Archer Daniels Midland. In 1995, a third plant, OSP3, began production, once again doubling production capacity at Ringaskiddy. In 2001, OSP4 was successfully completed to enable Ringaskiddy to continue to meet growing production demands by increasing overall capacity on the site by a further 40 percent.

Ireland's low corporate tax rate of 12.5% on trading profits has been a magnet for multinational companies who are responsible for 90% of Irish exports and a significant contributor to the success of the modern Irish economy, commonly known as the Celtic Tiger.

In addition, an Irish tax exemption on patent income, has promoted the parking of US multinational company overseas profits in Ireland, through transfer pricing and other accounting measures. Ireland is the most profitable location of US multinationals and in the period 1998-2002, the profits of US companies with Irish facilities doubled.

Ireland's annual corporate tax revenue is about €5.3 billion ($6.3 billion). The Wall Street Journal said in its report that a Microsoft Dublin-based company that is used for routing patent a royalty income from overseas operations, paid the Irish Revenue $300 million in taxes last year.


Ireland is the location of top US tech and pharmaceutical firms. Chipmaker Intel has its largest overseas manufacturing facility in Ireland, computer maker Dell is one of Ireland's largest employers and the top global drugs firm Pfizer, employs around 2,200 people at nine operations in Dublin and Cork. One of the products that it produces in Ireland is Lipitor, the anti-cholesterol treatment which is the world's biggest-selling drug.

The Intel Ireland campus, at Collinstown Industrial Park, Leixlip, County Kildare is Intel's fourth largest manufacturing site overall, and the largest outside the United States.

Intel, Dell, Pfizer and HP are among foreign-owned manufacturing firms in Ireland responsible for 90% of Irish exports.

Wyeth employs around 3,000 people in Ireland, between Wyeth Nutritionals in Limerick, Wyeth Medica in Kildare, Fort Dodge Laboratories in Sligo and the 90-acre Wyeth bio-pharmaceutical campus in Grange Castle, Dublin. This $1.5 billion research and development facility in west Dublin employs around 1,000 people, and is scheduled to hire another 200 over the next two years.

Pfizer Ireland has been a litigant in patent cases across the globe, including one as far away as New Zealand, against its near neighbour in County Cork, Eli Lilly.

On Sunday, The Sunday Independent reported that top executives at Dell Computer's Irish operation - including Vice President of Services and Operations in Ireland, Nicky Hartery - shared nearly $3.8m in tax-free dividends since 2003.

The dividends paid by Dell were paid through a patent royalty company called Dell Research Ltd. Recently filed accounts show that it had accumulated $91.7m in retained profits, none of which is subject to tax under current Irish legislation.

Pfizer alone had $38 billion of unremitted earnings at its international subsidiaries, according to its 2003 accounts.

Up to half of Irish corporate tax receipts may relate to taxes paid on profits transferred from other overseas units of US corporations, to its Irish subsidiaries.

In effect, the Irish tax exemption on patent income, could well fund over 5% of the Irish Government's planned total spending (current and capital) of €48.5 billion, in 2006.

HOW MICROSOFT REDUCES ITS GLOBAL TAXES

The Wall Street Journal said in its report two weeks ago : "*Ireland's citizens may not have heard of Round Island One, but they benefit greatly from its presence. Last year the unit handed the government of this small country of four million citizens more than $300 million in taxes.*

*The citizens of other nations where Microsoft sells its products are less fortunate. Round Island One provides a structure for Microsoft to radically reduce its corporate taxes in much of Europe, and similarly shields billions of dollars from U.S. taxation.*

*Giant U.S. companies whose products are heavily based on their innovations, such as technology and pharmaceutical firms, increasingly are setting up units in Ireland that route intellectual property and its financial fruits to the low-tax haven -- at the expense of the U.S. Treasury*."

The Journal wrote: "*Much of Round Island's income is licensing fees from copyrighted software code that originates in the U.S. Some of the rights to these lucrative assets end up in Ireland via complex accounting rules on intellectual property that the Treasury is now seeking to overhaul. The Internal Revenue Service said it is also looking closely at how companies account for such transactions.*

*In a statement, Microsoft said its European units "report and pay significant amounts of taxes" and that Microsoft "is fully compliant with the tax laws of the United States and all other countries."*

*Through a key holding, dubbed Flat Island Co., Round Island licenses rights to Microsoft software throughout Europe, the Middle East and Africa. Thus, Microsoft routes the license sales through Ireland and Round Island pays a total of just under $17 million in taxes to about 20 other governments that represent more than 300 million people*."

Microsoft's effective global tax rate fell to 26 percent in its last fiscal year from 33 percent the year before. Nearly half of the drop was attributed to "foreign earnings taxed at lower rates," Microsoft said in a Securities and Exchange Commission August filing. Microsoft leaves much of its profit in Ireland, including $4.1 billion in cash, avoiding U.S. corporate income taxes. But it still can count this profit in its earnings.

IRELAND TOP LOCATION OF US MULTINATIONALS' PROFITS

Ireland is the world's most profitable country for US corporations, according to analysis by US tax journal Tax Notes. In a study by the journal's Martin Sullivan that was published in 2004, it was found that profits made by US companies in Ireland doubled between 1999 and 2002 from $13.4 billion to $26.8 billion, while profits in most of the rest of Europe fell. In his analysis Sullivan termed Ireland a 'semi-tax haven' for US firms, because firms are involved in real productivity in contrast with locations such as Bermuda.

Between 1999 to 2002, US multinational corporations increased profits in countries with no taxes or low rates by 68% while sharply reducing profits recorded in countries where they engage in substantial business activity, the study published in the journal Tax Notes shows.

In 2002, US companies reported $149 billion of profits in 18 tax-haven countries, up 68% from $88 billion in 1999, according to Tax Notes, which analyzed the most recently available Commerce Department data. This compares with a 23% increase in total offshore profits earned by US multinationals during the same period-total profits of US multinationals' foreign subsidiaries around the world stood at $255 billion in 2002.

According to the New York Times, Commerce Department data not referred to in the Tax Notes study, suggest that US companies took 17 cents of each dollar of worldwide profits in tax havens in 2002, up from 10 cents in 1999.

Tax Notes shows that for each dollar of profit taken in Luxembourg in 1999, US corporations took $4.56 of profit in 2002. The result for Bermuda was $2.96; for Ireland $2.01; and for Singapore $1.72. These countries are viewed as tax havens or partial tax havens. For UK, each dollar of profit taken in 1999 was equal to 67 cents in 2002; for Germany, it was 46 cents.

A New York Times report last year notes that, in their public filings, companies are often unclear about what percentage of their profits comes from domestic operations as opposed to foreign operations, and they almost never discuss profit-shifting. For example, Pfizer, the pharmaceutical giant, said in its 2003 annual report that as of the end of last year, it had not made a United States tax provision on what it called $38 billion of unremitted earnings at its international subsidiaries. It was not clear whether that money was actually earned by the international subsidiaries or by Pfizer's operations in the United States and later shifted to those subsidiaries for tax purposes, and a Pfizer spokesman declined to provide any details or comments to the Times.

In October 2004, the Financial Times said that from 1994 to 2003, foreign profits of the six largest US pharmaceuticals companies went from 38 per cent of their overall income to more than 65 per cent. At the same time, the taxes paid on those profits fell from a rate of 31 per cent to 17.5 per cent, just half the US corporate tax rate.

In the case of the drug companies, the growing share of profits booked abroad - most of it in low-tax jurisdictions - does not reflect any significant shift in where those companies do business. Even as their overseas share of profits nearly doubled over the past decade, their overseas sales grew from just 40 to 43 per cent.

IRISH PATENT EXEMPTION

A & L Goodbody, one of Ireland's top law firms, says that patented inventions are a large source of revenue in the pharmaceutical industry. Ireland's tax exemption in respect of certain patent royalties, has been one of the driving factors behind investment by pharmaceutical multinationals, principally from the US, in the Irish economy.

Irish tax legislation provides an exemption from tax for income derived from "qualifying patents" when received by a person resident in Ireland and not resident in any other country. A "qualifying patent" is defined as a patent in relation to which the research, planning, processing, experimenting, testing, devising, designing, developing or similar activity leading to the invention, the subject of the patent, was carried out in Ireland.

A & L Goodbody says that the taxation reliefs to be derived from patented inventions goes further than to exempt the income from patent royalties from tax. Certain distributions by companies made out of income from certain patents which has been disregarded for corporation tax purposes, are themselves disregarded for the purposes of income tax on the part of a shareholder. This has very wide implications for investors in pharmaceutical companies considering carrying out any of their research and development in Ireland.

*Maximising Relief for Patent Income*

A & L Goodbody says that individuals or companies interested in knowing how to maximise benefits available under the patent royalty exemption should consider the following:

- establishing a separate company to do research and development work for the qualifying patent which will apply for, and hold the relevant patents; and
- this company should so far as is commercially viable, grant licences to unconnected third party users.

Patent royalties received by this company will be exempt from Irish corporation tax, and dividends paid on the ordinary shares of the patent holding company, or on other shares but only to the inventor or co-inventor, will be exempt from Irish income tax in the hands of the shareholders.

Click for more detail from A & L Goodbody.

Ireland's industrial development agency IDA Ireland, says that Ireland offers one of the most beneficial corporate tax environments in the world.

**A corporation tax rate of 12.5% applies to all corporate trading profits. The tax position of companies carrying out approved activities prior to 31 July 1998 will remain unchanged at 10% up until 2010.**

## European Corporate Tax Rates for substantial distributed trading profits

| | |
|---|---|
| **Ireland** | **12.5%** |
| Cyprus | 10% |
| Latvia | 15% |
| Lithuania | 15% |
| Hungary | 18% |
| Poland | 19% |
| Luxembourg | 22.88% |
| Portugal | 25% |
| Slovenia | 25% |
| Estonia | 22% |
| Germany | 26.38% |
| Czech Republic | 26% |
| Sweden | 28% |
| Finland | 29% |
| Slovakia | 19% |
| Denmark | 30% |
| UK | 30% |
| Italy | 33% |
| France | 33.33% |
| Belgium | 33.99% |
| Austria | 25% |
| Netherlands | 34.50% |
| Greece | 32% |
| Malta | 35% |
| Spain | 35% |

*Source - Deloitte & Touche, 2005*

## Percentage increase in profit required to achieve the same distributable income available in Ireland

| | |
|---|---|
| Germany | 46% |
| USA | 45% |
| Spain | 35% |
| Netherlands | 34% |
| France | 33% |
| Belgium | 33% |
| UK | 25% |
| Estonia | 18.24% |
| Cyprus | 2.94% |

*Source - Deloitte & Touche, 2005*

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Last Thursday, a New York Times editorial focused on the danger to America of exporting its ideas as virtually everything else in US manufacturing, is done overseas.

American Ingenuity, Irish Residence

The New York Times

*The newest expatriates aren't people. They're ideas, and we can't afford to watch them go. The Wall Street Journal reported last week that Microsoft had trimmed more than $500 million from its annual tax bill by putting a small subsidiary in Dublin in charge of $16 billion in assets. The game is simple: a company sends intellectual property to a tax-haven country like Ireland and keeps the tax difference on the money it earns.*

*The world is used to seeing manufacturing businesses move to countries where labor is cheaper, like Mexico or China. But profits from software created and designed at Microsoft's headquarters, in Redmond, Wash., should be taxed in America, not Ireland. Unfortunately, outsourcing is extending itself to taxes, in large part because the United States Congress has given businesses the loopholes to do it. That means that America's greatest asset - its intellectual property - could be sent offshore to reduce corporate tax burdens.*

*Microsoft's subsidiary is raking in the dough from licensing fees for copyrighted software, much of it originating in the United States. And what is the subsidiary's legal address? A Dublin law firm that advertises its smarts in turning Ireland into a tax shelter.*

*Microsoft's response is that it pays all taxes required by law. Worldwide, that came to more than $4 billion for the company's last fiscal year. Tax avoidance is a gray area, and exploiting the cracks in the system isn't a crime. But the resulting damage, in terms of bigger budget deficits at home, sure makes it feel as if something is wrong.*

*Microsoft isn't alone. A host of American tech companies have set up shop overseas, both for business and tax purposes. And as for the destinations, they're more than just Ireland; Singapore, for example, also attracts businesses with low corporate rates. But one of Ireland's advantages for tax dodging over, say, Bermuda, is its plausibility as a home for genuine investment because it is a place where foreign corporations have built and staffed offices and plants. Microsoft has 1,100 full-time employees in Ireland, for example, compared with 40,000 in the United States.*

*That means, in a particularly hard-to-swallow twist, that the tax havens encourage companies to send increasingly large chunks of their businesses offshore as well. By pushing more of their jobs and investments overseas, the companies make the tax havens seem more legitimate.*

*American companies' successful hunt for low-tax opportunities overseas has been used as an argument for slashing corporate taxes at home. Maybe we should close the loopholes first, and provide the Treasury Department with the resources it needs to enforce existing law. After that, it's clear that meaningful corporate tax reform is needed. For an economy increasingly based on products with little physical substance - drug recipes, images, sounds, strings of ones and zeroes - it wouldn't take long to lose it all.*